FIFTY-FIRST

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1964

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS IN 1964

Period	Action	Purpose
January–mid-August	Increased the System's holdings of U.S. Government securities, after having reduced them seasonally early in the year. On balance, total holdings rose about $1.1 billion, $300 million of which represented net purchases of securities with maturities of over 1 year. Member bank borrowings averaged about $275 million.	To provide for moderate growth in the reserve base, bank credit, and the money supply for the purpose of facilitating continued expansion of the economy while fostering improvement in the capital account of U.S. international payments, after offsetting seasonal downward pressures on short-term interest rates early in the period.
Mid-August–late November	Increased the System's holdings of U.S. Government securities by about $1.5 billion, of which $600 million represented net purchases of securities with maturities of more than 1 year. Member bank borrowings averaged about $350 million.	To maintain slightly firmer conditions in the money market with a view to minimizing the outflow of funds attracted by higher short-term interest rates abroad while offsetting reserve drains and providing for growth needs of the domestic economy.
Late November	Raised discount rates from 3½ to 4 per cent. Raised maximum interest rates payable on savings deposits held for less than 1 year from 3½ to 4 per cent and those on other time deposits from 4 to 4½ per cent for maturities of 90 days or more and from 1 to 4 per cent for maturities of 30-89 days.	To counter possible capital outflows that might be prompted by any widening spread between money market rates in this country and the higher rates abroad, following a rise in official and market rates in London, while at the same time ensuring that the flow of savings to commercial banks remains ample for the financing of domestic investment.
Late November–December	Increased the System's holdings of U.S. Government securities by about $765 million, part of which represented securities acquired under repurchase agreements. Member bank borrowings averaged about $275 million.	To offset seasonal reserve drains and to accommodate further moderate expansion in aggregate bank reserves while ensuring that the rise in money market rates following the discount rate actions did not restrict the availability of domestic credit.

December 15, 1964

Authority to effect transactions in System Account.

Reports at this meeting indicated that domestic economic activity, after being dampened by work stoppages earlier in the fall, currently was being stimulated by efforts of auto producers to rebuild dealer inventories while satisfying accumulated demands and by attempts of steel users to increase stocks against the possibility of a steel strike next spring. It appeared likely that these influences would continue to encourage inventory investment in early 1965.

As the year drew to a close, the course of activity in most other sectors of the economy was showing little change from earlier months. Business and consumer confidence remained high; recent surveys indicated that both groups planned to increase spending in the months ahead. On balance, short-run prospects for continuing economic expansion appeared to be good if activity was not disrupted by major strikes.

With respect to the longer run, some members of the Committee noted that the temporary stimulus to activity of recent and threatened strikes might end at a time when other factors also were acting to dampen activity, including a shift in the position of the Federal budget from deficit to near-balance or surplus. This raised the possibility in their minds that the pace of activity might slacken in the coming year.

The unemployment rate declined slightly to 5.0 per cent in November but remained within the narrow 4.9-5.3 per cent range that had prevailed since May. Joblessness was heavily concentrated among the unskilled, particularly younger workers; the unemployment rate among married men was at its lowest level in 7 years, and shortages of some kinds of skilled labor were being reported. Further increases in employment could be expected with rising activity, particularly in trade and public and private services where gains had continued to be strong and

steady. But the labor force also was expected to grow rapidly because of a large increase in the number of young people seeking jobs. While recognizing that adequate credit was important to a dynamic and expanding economy, a number of members of the Committee indicated that they thought merely increasing over-all demand by expanding credit at this juncture would not solve the unemployment problem stemming from lack of education and training.

Weekly estimates suggested that average industrial commodity prices rose slightly further in November and early December, following a larger advance in October. Because of declines in prices of farm and food products, however, the average for all wholesale prices apparently remained stable. Upward pressures on prices of nonferrous metals had been maintained recently by high rates of activity in the United States and abroad and, in some cases, by political disturbances and strikes that limited production. The consumer price index continued its mild upward drift in October.

The rate of growth in total bank credit had fluctuated erratically in recent months partly because of the pattern of Treasury financing operations. November witnessed an exceptionally large expansion, with much of the unusual size of the increase attributable directly and indirectly to Treasury financings in that month. This brought the annual rate of growth of bank credit since midyear to about 8 per cent, the same rate as in the first half of 1964 and in the year 1963. Recent fluctuations in the growth rate of the money supply appeared to reflect mainly shifts between private and Government deposits and short-run adjustments by the public in its money balances. In the year to date the money supply had increased at a 4.2 per cent rate, compared with 3.8 per cent in 1963.

Member banks used part of the reserves supplied by System open market operations to reduce their borrowings from the Federal Reserve Banks in the wake of the late November increase in the discount rate. Although excess reserves also were reduced somewhat, free reserves rose substantially in the most recent statement week. Federal funds were readily available, frequently at rates below the discount rate.

Yields on 3-month Treasury bills declined about 10 basis points in the first week of December, but subsequently they returned to about 3.85 per cent, the level that had been reached shortly after the discount rate action, as seasonal pressures converged on the money market. These pressures were expected to reverse with the passage of the December tax and dividend dates and the holiday shopping season. Bond yields, which had risen slightly in an initial adjustment to the change in the discount rate, fell back to about earlier levels. The decline was attributable in part to expectations of continuing large flows of savings and little or no rise in long-term credit demands. It also reflected market responses to recent official statements concerning interest rates and credit availability, and to the cancellation by several commercial banks of increases in their prime rate announced earlier. While market yield relations were still expected to be subject to stresses of various sorts, the net effect to date of the adjustments to the discount rate action had been a further flattening of the yield curve in the shorter maturity range.

It was reported that the Treasury probably would raise new cash early in 1965 through additional bill sales. The possibility also was noted that an advance refunding operation would be undertaken in January if market conditions were considered favorable.

In foreign exchange markets, attention continued to be focused on developments in sterling. While that currency appeared to have weathered the recent crisis, the situation had not yet been fully stabilized, partly because of adverse seasonal pressures.

The precise magnitude of the U.S. balance of payments deficit in the fourth quarter was still in doubt but the deficit for 1964 as a whole seemed likely to be on the order of $2.5 billion, compared with $3.3 billion in the preceding year. Net outflows of

U.S. private capital rose substantially in 1964 to a new record level. The estimated reduction in the over-all deficit was attributable to a further marked increase in the trade surplus, as exports continued to expand rapidly while the growth in imports remained moderate. The gain in the trade surplus was due partly to vigorous economic expansion abroad and partly to the improved competitive position of U.S. goods in world markets as average prices continued to be relatively stable domestically but rose in many foreign countries.

A continuation in 1965 of favorable developments in U.S. foreign trade seemed possible, particularly if domestic prices remained stable. However, there were some factors that appeared unfavorable and that might slow or perhaps even reverse the recent trend. Among these were the restrictive actions—including surcharges levied on imports—that Britain had taken to alleviate its balance of payments difficulties; the possibility that the European Economic Community would reach decisions on farm policy that would reduce U.S. agricultural exports to its members; and the prospect of less buoyant expansion and slower price advances in some industrial countries. At the same time, U.S. imports might rise more briskly in coming months, particularly if inventory demands were strong. On the whole, it appeared to many Committee members that any substantial further improvement in the U.S. balance of payments position in 1965, in a context of continuing domestic expansion, would have to occur mainly in the area of capital flows.

The Committee concluded that no change in policy should be made at this time in view of the various uncertainties characterizing the domestic and international situations, the prospective reversal of seasonal pressures in the money market, and the possibility of a Treasury financing operation soon. It was agreed that for the time being open market operations should continue to be directed primarily at maintaining stable money market conditions, while permitting short-term interest rates to fluctuate within their recent range. Some members felt that a slighly lower range of bill rates would be appropriate if brought about by the expected abatement of seasonal pressures. Others, while agreeing with the majority that the balance of factors militated against a policy change now, expressed continued concern about the persisting sizable balance of payments deficit and about recent growth rates of bank credit and the money supply.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

In light of the economic and financial developments reviewed at this meeting, it remains the Federal Open Market Committee's current policy to facilitate continued expansion of the economy by accommodating moderate growth in the reserve base, bank credit, and the money supply, while seeking to avoid the emergence of inflationary pressures and to strengthen the international position of the dollar.

To implement this policy, and recognizing that international uncertainties and year-end seasonal pressures continue to require a larger than usual degree of flexibility in operations, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as currently prevail.

Votes for this action: Messrs. Martin, Balderston, Hickman, Mitchell, Robertson, Shepardson, Shuford, Swan, Wayne, and Treiber. Vote against this action: Mr. Mills.

Mr. Mills dissented from this action on the grounds that current money market conditions were easier than he thought justified by immediate or prospective developments. He favored a somewhat more restrictive credit policy because of the possibility of massive inventory stockpiling, the further upward movement in prices of strategic industrial materials, and the evidences he saw of pervasive but latent inflationary pressures. In his judgment a modest tightening in the supply of reserves and in credit availability would still leave reasonable leeway for appropriate credit expansion without encouraging the commercial banking system to press unduly for a further increase in its holdings of loans and investments.

The following two reports describe the actions taken during 1964 to carry out the policies of the Federal Open Market Committee. The first one is a chronological review of operations in domestic securities. In providing the reserve base for rapid expansion in commercial bank credit and for substantial growth in the money supply—and in view of the public's changing preferences for currency, demand deposits, and time deposits—the Federal Reserve acquired during the year \$3.5 billion, net, of U.S. Government securities (including repurchase agreements).

The report on operations in domestic securities was prepared by Robert W. Stone, Manager of the System Open Market Account, who supervises these operations. It is written from the vantage point of the Trading Desk at the Federal Reserve Bank of New York, where operations in these securities are effected to carry out the policy directives of the Federal Open Market Committee. The report stresses the factors—including variations in reserve elements, money market tendencies, and Treasury financings—that the Manager takes into account in the day-to-day provision of bank reserves.

The second report is a review of Federal Reserve operations in foreign currencies. The Federal Reserve has been buying and selling such currencies since early 1962 as part of the efforts to defend the dollar and strengthen the world payments system. During 1964 the volume of Federal Reserve operations in foreign currencies was substantial, and the reciprocal currency, or "swap," network linking the Federal Reserve with foreign central banks and the Bank for International Settlements was enlarged by \$300 million.

During the year the Federal Open Market Committee authorized outright forward sales of foreign currencies. The reinforcement of the swap lines and the actual foreign exchange transactions exerted a strongly stabilizing influence on both gold and foreign exchange markets, which remained calm in the face of several potentially dangerous developments during the year.